Mitigating risk in your supply chain: The power of due diligence

A overview to procurement managers on how to manage supply chain risk with due diligence
Presentation aims

- How the procurement process currently assesses risks
- Common strengths and weaknesses of procurement frameworks
- Reasons why contracts fail?
- The greatest risk – not knowing what you don’t know
- The power of due diligence – the key to mitigating risk
- Supplier performance maintenance – once a supplier has been selected, is that the end of it?
- Unique attributes of private companies
Overview of current procurement practices
What is risk?

Risk is the potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome).

Potential losses themselves may also be called "risks".

Almost any human endeavour carries some risk, but some are much more risky than others.
Overview of current practices

Most organisations utilise the following approach to procurement

<table>
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<tr>
<th>SCOPING</th>
<th>SELECTION AND CONTRACTING</th>
<th>CONTRACT PERFORMANCE AND COMPLETION</th>
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<tr>
<td>Assess requirements of the organisation</td>
<td>Develop selection criteria and risk assessment tool for assessing suppliers</td>
<td>Implement</td>
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<td>Assess existing market solutions</td>
<td>Determine information required for selection process &amp; ongoing monitoring</td>
<td>Monitor performance</td>
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<td>Formulate options in the market available to meet requirements</td>
<td>Go to market in requesting tenders</td>
<td>Monitor risk</td>
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<td>Engage relevant internal stakeholders in procurement process</td>
<td>Evaluate and select preferred supplier</td>
<td>Review and close</td>
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<td>Determine key contracting needs and risk mitigation mechanisms required</td>
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The core objective of any procurement and strategic sourcing programme is to maximise value for the purchasing entity.

**Outcomes** of an effective procurement model

- Innovation
- Sustainability
- Governance
- Product Quality
- Supply security
- Cost reduction

**The VALUE in getting it right**

**Risk Mitigation and Reduction**
- Commercially viable vendors
- Commercially sound contracts
- Improved supplier performance

**Best Practice Procurement**
- Reduced costs
- Operational efficiencies
- End-to-end supply chain efficiencies
- Improved documentation, tools and processes
Procurement due diligence – a concept
## Procurement due diligence – a concept

<table>
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<tr>
<th>Procurement planning (scoping)</th>
<th>Supplier selection and contracting (tender assessment)</th>
<th>Contract performance and supplier monitoring (supply period)</th>
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| **Risks (supplier)**          | • Not understanding the complexities of the supplier and how to interpret information on the supplier’s business  
                              | • Unable to form conclusions on the risk profiles of the supplier  
                              | • Inability to determine if the supplier remains financially able to deliver under the agreement  
                              | • Not having visibility of any significant events with the supplier that may impact either the supply or the supply relationship |
| • Failure to consider financial viability of supplier in assessment criteria  
• Failure to request adequate information in Request For Proposal (RFP) or failure to leave scope for further requests  
• Failure to adequately detail the assessment process and ongoing requirements for the supplier in the RFP contract  
• Failure to consider the probity process  
• Increased likelihood of project failure or inefficiencies due to lack of controls being implemented | | |

**What should one do?**

**Supplier due diligence:**
- Identify appropriate information requirements in drafting of the RFP
- Agree on the scope that needs to be applied to the final bidding parties that you wish to be investigated
- Conduct financial due diligence, analyse the key risks of the supplier and also conducting background checks
- Generate a risk profile of the supplier, with recommendations on how you may be able to mitigate those risks
- Review and ensure probity in the selection process
- Provide risk mitigation strategies to ensure successful project completion results with the supplier

**Supplier monitoring:**
- Agree on the scope, to determine the activities to be undertaken in monitoring the contracting entity (e.g. frequency, depth of financial and commercial analysis)
- Conduct a regular independent risk profile assessment of the entity
- Understand the risk profile of the supplier, and recommendations on how you may mitigate any risks or issues identified
- Provide feedback to the supplier, so that they have the best opportunity to address the issues raised and take steps towards correcting the risks identified
- Enhance supplier relationship management by encouraging communication between you and the supplier
What you should do and why?

Supplier due diligence (pre-contracting with your supplier)

Supplier due diligence assists your project in:
- Determining what information you should be requesting from the supplier for the tender process;
- Understanding the risk profile of the supplier and the individuals associated with it; and
- Developing commercial and financial conditions in your final contract with the successful bidding supplier.

How will this add value to your procurement process?

1. Help you make more informed decisions
   Developing the tender information request for suppliers will ensure you receive the necessary information from the supplier at the start of the supplier evaluation process.

2. Better understand the unique risks of the private company
   Enable you to understand the risks associated with the supplier and implement risk mitigation strategies.

3. Manage supply chain risk more effectively
   By understanding the risks unique to your supplier, you can develop appropriate contracting arrangements to manage your risk.
What you should do and why?

Supplier monitoring (during contract performance)

Supplier monitoring assists your procurement team in:
- Determining what information you should be requesting from entities during contract performance, so to enable effective monitoring thereof (e.g. frequency, depth of financial & commercial analysis);
- Monitoring and assessing the risk profile of the supplier; and
- Determining what commercial and financial remedies you could implement with the supplier.

How will this add value to your procurement process?

1. Effective monitoring and reporting mechanism
   Risks identified during the tender phase will only be effectively managed if there is regular monitoring and assessment of those risks – this is the first line of defence to supplier issues affecting your operations.

2. Develop strategies to address issues identified on a timely basis
   Develop strategies that can mitigate the risks identified during the monitoring process.

3. Opportunity for performance improvement feedback
   Provide feedback to the supplier (where possible), so to that they have the best opportunity to address the issues raised and ultimately take steps towards reducing the risks identified.
Private Companies – some unique attributes
Overview of Private Companies

Private companies are unique in their attributes and are distinct from public companies

Why and how?

- Ownership is concentrated to a small group of shareholders (<50), sometimes a family, and it is not listed on a public exchange

- There is enormous diversity in size – whilst many may have revenues of <$10m, there are many private companies that are as large or larger than publicly held companies

- Disclosure requirements that are applicable to public companies do not apply to all private companies, frequently resulting in limited publicly available information

- The interests of the business are closely aligned with the personal interests of the shareholders – this can be a great strength and weakness at the same time

- Shareholders are likely to be management of the business

- Frequently, private companies do not have a robust internal risk management and governance frameworks in place
Overview of Private Companies

What are the key risks that are unique to a private company or family business?

- The success of a Private Company is frequently directly associated with the performance and personality of a few key individuals, who also own (and manage) the business. This can be a great strength, but also a significant risk if there is a change at this level, or it ceases to function effectively.

- Obtaining adequate information on a Private Company is frequently very difficult. Without adequate planning in what information you wish to obtain pre contracting and post contracting, your procurement team will not be able to effectively manage supplier financial risk.

- The above can be complicated further if the business is a Family Business, as it introduces family issues into the business environment.

- Additionally, Family Businesses typically have a different risk profile. Due to the inherent nature of family businesses, their strategies and investment horizon are usually for the long-term and they more often than not have strong balance sheets.

- Private Companies and Family Businesses are frequently in need of undertaking a professionalisation process, whereby their internal systems (financial, risk management, human resources, regulatory compliance, corporate governance processes etc) require improvement. Relying on a supplier without adequate internal processes poses risk to your organisation.
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